



IN THE
SUPREME COURT OF THE UNITED STATES
October Term, 1977

No. **77-1776**

Frank J. Beardslee and
Frances M. Beardslee,
his wife,

Petitioner,

v.

United States of America,
Respondent.

Petition for Writ of Certiorari
to the
United States Court of Appeals
For the Sixth Circuit

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PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

Frank J. Beardslee and Frances M.
Beardslee, pray that a Writ of Certiorari
issue to review the judgment of the
United States Court of Appeals for the
Sixth Circuit entered in this case on
September 14, 1977 affirming the judg-
ment of the United States District Court

for the Western District of Michigan Southern Division, entered September 3, 1975.

OPINIONS BELOW

The opinion of the Court of Appeals is reported in 562 F.2d at 1016. The opinion of the District Court in the case entitled United States of America, plaintiff, v. Frank J. Beardslee and Frances M. Beardslee, Defendants is unreported. The opinions are reprinted in the Appendix commencing on pages A-1 and A-13, respectively.

JURISDICTION

The judgment of the Court of Appeals was entered September 14, 1977, and the Order Denying Petition for Rehearing was entered on February 21, 1978. This Court has jurisdiction to review the judgment by Writ of Certiorari under 28 U.S.C. §1254 (1).

The Complaint in the District Court based jurisdiction upon 28 U.S.C. §1345.

QUESTIONS PRESENTED

In its opinion the Sixth Circuit Court of Appeals stated (A-9j):

"Thus this Court is faced with the task of formulating a federal rule of law where no relevant federal precedent exists."

Is the decision of the Sixth Circuit Court of Appeals contrary to the decisions in the following Supreme Court and Court of Appeals decisions?

United States v. Yazell
382 U.S. 341 (1966)

Wallace v. Panamerican Petroleum Corporation - 384 U.S. 63

Weinstein v. United States
511 F.2d (6th Circuit, 1975)

United States v. MacKenize
510 F.2d (9th Circuit, 1975)

If so, did the Court of Appeals err in failing to follow the applicable rules of law enunciated in those decisions?

Should the Supreme Court review the decision of the Sixth Circuit to secure and maintain uniformity in the decisions of this Court and the Circuit Courts of Appeals?

In reaching its conclusions did the Court of Appeals in affirming the judgment of the District Court, err in its holdings on the following questions:

1. Can powers granted to the Respondent by an amendment to 15 USC 634 in 1974, followed by 13 CFR §101.1 (d) be given ex post facto effect to determine the "federal interest" in prior guaranty agreements drafted on SBA (U.S.) forms by a Michigan bank?

2. Is the Respondent, upon being assigned by a Michigan bank, notes and security documents executed intra-state between the bank and a Michigan corporation bound by the same Michigan laws in its enforcement as the bank would have been, absent the assignment?

3. Does the Respondent have to establish an "overriding federal interest" under the facts of this case, before it can avoid Michigan law in its enforcement of Michigan agreements assigned to it by a Michigan bank?

4. Did Respondent establish an "overriding federal interest" under the facts as shown in the record of this case?

5. Is the Federal Court bound to give full force and effect to the determination of the Bankruptcy Court ap-

proving stipulations and agreements between Respondent and Beardslee Lumber Company and its Receiver which affected Petitioners' guarantees?

6. Did Federal Court fail to give that full force and effect to the Bankruptcy Court Order approving the discharge of all liability of Beardslee Lumber Company and the transfer of Petitioners guaranty agreements to Freeport Hardwood Corporation and the subsequent discharge thereof?

7. Did Respondent's transactions and settlement with Freeport Hardwood Corporation constitute payment in full of the original Beardslee Lumber Company obligations as guaranteed by Petitioners?

8. Do the general rules in the law of Guaranty apply to the construction of the Guaranty Agreement prepared by Respondent (SBA) and signed by Petitioners, under the facts here?

9. Did the Petitioners waive the Defense of the Discharge of the Principle Debtor by the provisions of the Instruments of Guaranty?

STATUTES AND REGULATIONS

15 U.S.C. 634

13 CFR §101.1(d)

STATEMENT OF THE CASE

Beardslee Lumber Company, Debtor, executed promissory notes in favor of National Bank of Hastings in October, 1964 and in May, 1967, with principal amounts of \$140,000.00 and \$120,000.00, respectively. The notes were later assigned to the Small Business Administration (Respondent). The notes were secured by the following documents:

- A. Mortgage on the real estate of the Debtor in Freeport, Michigan.
- B. Security agreements covering the machinery and equipment of the Debtor located on the real estate in Freeport, Michigan.
- C. Guaranty Agreements signed by Frank J. Beardslee and Frances M. Beardslee, his wife, which are the subject of this action.

All original agreements, notes, mortgages, security agreements and guaranties in issue here were between the National Bank of Hastings, a Michigan banking corporation, and Beardslee Lumber Company, a Michigan corporation, or its guarantors.

Beardslee Lumber Company, Debtor, filed proceedings for an arrangement under Chapter XI of the Bankruptcy Act

in the United States District Court for the Western District of Michigan, Southern Division (No. 30997N). On March 8, 1968, the Small Business Administration (United States of America) filed in those proceedings its proof of secured and priority claims, listing the two notes above referred to. The claim covered the entire indebtedness claimed by the SBA against Beardslee Lumber Company, Debtor.

By Order of the Referee in Bankruptcy Court, June 9, 1969, in the arrangement proceedings, with the specific approval of the SBA, the plan of arrangement was amended, pursuant to which the Debtor deeded to Freeport Hardwood Corporation, a Michigan corporation, its real property and transferred to that corporation its personal property located in Freeport, subject to the mortgages and security interests, specifically including the guaranties, outstanding in favor of the SBA. By the same instrument, Beardslee Lumber Company, Debtor, was released from the mortgage and the security interest obligations. Freeport Hardwood Corporation thereupon took possession of said property.

After this transaction, Freeport Hardwood Corporation entered into an agreement with the SBA dated September 9, 1969, pursuant to which it gave the SBA its promissory note in the amount of \$126,921.95, secured by real estate mortgage, security agreement and a personal guaranty executed by some of its officers. Petitioners also signed as guarantors. SBA credited this amount to the account it carried in the name of Beardslee

Lumber Company. The agreement provided that the SBA would discharge the security interests and the mortgage executed by Beardslee Lumber Company upon the payment of the note. The agreement provided that upon payment of the obligation of Freeport Hardwood Corporation, SBA "hereby agrees to release and discharge in favor of Freeport Hardwood Corporation all of its security interests . . . reflected in those certain security agreements dated respectively October 22, 1964 and May 3, 1967, executed by Beardslee Lumber Company . . ."SBA also agreed to forebear foreclosure of the Beardslee Lumber Company mortgages so long as Freeport Hardwood Corporation was not in default. The new officers of Freeport signed new guaranty agreements similar to the ones signed as security for Beardslee Lumber Company by Petitioners.

On May 20, 1970, approved by order of the Referee on June 22, 1970, the SBA entered into an agreement with the Debtor, Beardslee Lumber Company, and with Marshall Kindey, Receiver of the Debtor, for the payment of \$5,000.00 from the proceeds of a Circuit Court settlement, pursuant to which all debts owing to the SBA from Beardslee Lumber Company were released and discharged. As to the prior transfer to Freeport Hardwood Corporation, said stipulation in paragraph 5 stated:

"The security for said claim has been released and discharged by said SBA pursuant to an Amendment to Arrangement dated

June 6, 1969, and approved by order of David E. Nims, Jr., Referee, entered June 9, 1969, but without prejudice to any priority or any unsecured claims which SBA may have against said Debtor."

The District Court has found in this case that agreement completely discharged Beardslee Lumber Company, Debtor, from all obligations to SBA. Opinion 10-10-72 p.2 (Appendix 16)

Upon the failure of Freeport Hardwood Corporation to make payment when due on its note and agreement with the SBA, on February 5, 1971, the United States filed its complaint for foreclosure of mortgage and security agreements and for a deficiency judgment. The suit was filed in the District Court for the Western District of Michigan, being Civil Action No. 6510. That suit was settled by agreement between the parties April 14, 1971, pursuant to which the mortgages and the security interests executed by Beardslee Lumber Company were discharged by the SBA. The mortgage discharges were dated April 14, 1971, and recorded May 12, 1971. The District Court's decision on the motion for summary judgment does not refer to this settlement and discharge of security covering the Beardslee Lumber Company notes, although it was in evidence.

The Petitioners in this case, the Guarantors, were not parties to, nor did they consent to any of the transactions

between the SBA and Beardslee Lumber Company during the arrangement proceedings, nor were they a party to, nor did they consent to the transactions between the SBA and the Freeport Hardwood Corporation, pursuant to which the security interests and the real estate mortgages executed by Beardslee Lumber Company were released and discharged. They did, however, sign the September 9, 1969 agreement between SBA and Freeport as guarantors, to reflect the transfer of their guarantees from Beardslee Lumber Company to Freeport, under the Amendment to the Plan of Arrangement.

REASONS FOR GRANTING THE WRIT

- I. This case involves issues of substantial importance, and the opinion of the United States Court of Appeals for the Sixth Circuit is in conflict with opinions of this Court and other Courts of Appeals on the question of choice and application of law.

The Sixth Circuit Court of Appeals regarded this case to be one of first impression as to a major issue presented. It stated (562 F.2d at 1022):

"Thus, this court is faced with the task of formulating a federal rule of law where no relevant federal precedent exists."

A. THE FACTS OF THIS CASE SHOW "NO OVERRIDING FEDERAL INTEREST" TO PERMIT THE COURT TO DISREGARD MICHIGAN LAW

This Court's opinion leaned heavily for its decision upon 13 CFR §101.1 (d), a 1974 regulation promulgated by the SBA (U.S.) after 15 U.S.C. §634 was re-enacted by Congress. The Court concluded (562 F.2d at 1022) that federal law should apply to the resolution of the issues in this case. We submit that the Court's finding that the SBA (U.S.) regulation eliminated the necessity of proving an "overriding federal interest" in determining that federal law and not state law should apply is error under the facts of this case.

In Clearfield Trust Company v. United States 318 U.S. 363 (1942) cited by the Court of Appeals and used in its conclusion that the doctrine of the Clearfield Trust supported the use of federal rather than state law here, does not support the Court's conclusion. It was decided long before the SBA (U.S.) regulation relied on by the Court here. That case involved a check drawn on the United States Treasury. The Court found an "overriding federal interest" was present, and concluded, "the rights and duties of the United States on commercial paper which it issued are governed by federal rather than local law". 318 U.S. at 366.

In United States v. Yazell 382 U.S. 341 (1966) in finding that the federal

interest was not sufficient to override the state law, the problem was stated as follows, "Our problem remains: whether in connection with an individualized, negotiated contract, the Federal government may obtain a preferred right which is not provided by statute or a specific agency regulation, which was not a part of its bargain, and which required overriding a state law dealing with the intensely local interests of family property and protection (whether or not it is up-to-date or even welcome) of married women." In United States v. Vince 270 F. Supp. 591 (E.D.La. 1967), in finding that the state law should be applied to the case the Court cited Yazell, supra, for the statement "Unless there is an overriding federal interest present, the Court is not warranted in overriding applicable state law." 270 F. Supp. at 594

Weinstein v. United States 511 F.2d 56 (6th Cir. 1975) was cited by the Court in its note at the bottom of A-9i. There it was pointed out that, "Of course there is no question that such compliance was required if the sale in this case was by the Capital National Bank rather than the SBA." 511 F.2d at 58. The Court pointed out also in that case that "the SBA is required to comply with state laws enacted to protect its citizens where such compliance does not interfere with a federal interest."

In United States v. Martin 344 F. Supp. 350 (E.D. Mich. 1972), the defendants had obtained a loan from a local bank in Louisiana which was later assign-

ed by the bank to the SBA. In that case the Court found that the federal law governed as to the institution and maintenance of the action but held that the substantive state law applied in construction of the contract, citing Yazell, supra.

In the case of United States v. McKenzie 510 F.2d 39 (9th Cir. 1975), the finding of an overriding federal interest was required by the Court even though the case decided after the SBA regulation had been adopted which was relied upon by this Court. It involved the state redemption laws as related to SBA loans. The government had refused to apply the state laws in its mortgage foreclosure. The Court compared the facts there with the facts in Yazell, supra stating "The SBA loans were individually negotiated in painful particularized detail . . . and by thwarting debtor protections imposed by state law, the government obtained an unconscionable advantage over debtors by gaining rights that no other creditor could have had." 510 F.2d at 41. The Court stated, "the governmental interest in Yazell and in our cases are identical. We can justify a departure from Yazell only if we can reasonably conclude that a state's interest in protecting its debtors from inflated deficiency judgments and from unfair prices at foreclosure sales are of lesser moment to the states concerned than was the 'quaint doctrine of coverture' (Yazell) to the State of Texas, or that the former weigh less heavily than the

latter when each is balanced against the same federal interest." 510 F.2d at 41. The Court in McKenzie pointed out that the application of state law would further rather than conflict with the federal purpose. This is very similar to the facts of the case at bar.

The Michigan purpose is to protect debtors from having their security extinguished, leaving them with only an obligation, and no recourse for the debt. In McKenzie the recourse was the value of the security sold at foreclosure sale. In the case at bar the value included all of the Beardslee Lumber Company assets transferred to Freeport subject to all of the security documents supporting it which the SBA ultimately discharged, although it denies discharge of one of the security documents - the Beardslee guarantees. The McKenzie case refused to rely upon the SBA regulation as a substitute for proof of an overriding federal interest and we submit that the Court here was in error in so doing. See also United States v. Marshall 431 F. Supp. 888 (N.D. Ill. 1977), and Wallace vs. Panamerican Petroleum Corporation 384 U.S. 63.

B. THIS CASE INVOLVES A CONTRACT BETWEEN A MICHIGAN BANK AND TWO MICHIGAN RESIDENTS. THE COURT OF APPEALS ERRED IN HOLDING FEDERAL LAW WAS CONTROLLING.

Only upon proof of an "overriding federal interest" can the Michigan laws

of assignment be disregarded and federal laws substituted. (supra) No such showing can be found in the record. The general rule is stated in 11 Am. Jur. 2d, Bills and Notes, 373, at 397:

"The transferee takes title subject to all of the defenses and equities to which the instrument was subject in the hands of the transferor . . ."

On the subject of assignment, 11 Am. Jur. 2d §313, at 338 states:

"An assignment of a bill or note merely means a transfer of the title to the instrument, and generally, an assignee takes only such title as his assignor had, subject to all defenses available against the assignor."

Since the Michigan law would be applicable here, if the principal were enforcing the instruments that were individually negotiated between the bank and the Beardslee Lumber Company and the Petitioner guarantors, under the facts of this case the SBA should be subject to the same Michigan laws for determining whether Petitioners have waived the defense of the discharge of the principal as would have applied to the Hastings Bank.

II. Important questions were wrongly decided below.

A. GUARANTORS (PETITIONERS) DID NOT
WAIVE THE DEFENSE OF THE DIS-
CHARGE OF THE PRINCIPAL

The District Court's determination that the Guarantors (Petitioners) had waived the defense of release of the principal was based solely upon the wording of the SBA's Guaranty Instrument and without any citation of legal authority. The District Court quoted from the first sentence of the Guaranty but left out a very important part of that sentence, " . . . all sums payable . . . with respect to the Note of the Debtor." (A-17)

The District Court included in his opinion (A-18) a photocopy of the section of the Guaranty Agreement concerning SBA's rights with respect to the collateral given by the Debtor (Beardslee Lumber Company), but omitted reference to the next paragraph which dealt specifically with SBA's rights if the Debtor defaulted.

The Respondent (U.S.) made no claim in this case that the waiver exception or any other exception to the general rules of guaranty applied to the facts of this case. We submit that the District Court erred in finding the waiver exception applied from the Guaranty agreement provision and that the Court of Appeals erred in affirming that erroneous decision.

B. THE GENERAL RULES OF GUARANTY
APPLY HERE REQUIRING DISCHARGE
OF GUARANTORS.

1. The Guarantors are accessories to the debt of the principal obligor (Beardslee Lumber Company).

The wording of the Guaranty Agreement makes the Guarantors an accessory to the debt of the principal. It defines the obligation of the Guarantors as "the due and punctual payment when due . . . of the principal and interest . . . with respect to the note of the Debtor." The Guaranty also states "in case the Debtor shall fail to pay according to the terms of said note, the undersigned (guarantors) . . . will pay the amount due and unpaid by the Debtor . . ."

The Court has found that the Debtor was discharged by agreement with the SBA (Appendix 16). This means the notes were extinguished as to the Debtor. Since there is no amount due and unpaid by the Debtor, the principal, there can be no amount due or owing by the accessory, the Guarantors.

The facts of this case require judgment for the Petitioners, the Guarantors under the universally accepted principles of the Law of Guaranty. The authorities are uniform in upholding the rule of law that the release or discharge of the Principle Debtor will discharge the Guarantor. See, e.g., 38 Am. Jur. 2d, Guaranty, at 1085, 1086; 11 Callaghan's Michigan Civil Jurisprudence, Guaranty, at 503; 38 C.J.S., Guaranty, at 1231, 1245, 1252; Annotation, 38 L.R.S. (N.S.) at 875.

Directly in point is the case of Banana Sales Corporation v. Chuchanis, 119 Ohio St. 79; 162 N.E. 274 (19). The sale of goods had been guaranteed by the Defendant. The Creditor and the Debtor had made an agreement under which the Creditor had taken the goods back and the Debtor was released. The Creditor applied the proceeds of the liquidation of the goods on the debt and sued the Guarantor for the balance. The Guarantor had had notice of the agreement between the Creditor and the Debtor but had not participated in it or agreed to it. The following quotation from that decision found in 162 N.E. 275, at 276, is pertinent here:

"There is no doubt that the debt of George & Shanan due the sales corporation, and for which Chuchanis was Guarantor, was fully paid and discharged as shown by the release. This being conceded, Chuchanis was also discharged from liability, since there can be no liability upon the part of a Guarantor if there is no valid obligation against the Principal Debtor. This has long been the established principle in this state. As early as 1853 this Court stated:

'It is of the essence of the contract, that there be a subsisting valid obligation of a Principal Debtor. Without a Principal, there can be

no accessory; and by the extinction of the former, the latter becomes extinct. This results from the nature of the obligation of suretyship . . . It would seem to follow, from the very nature of the undertaking, that if the principal contract is absolutely void, the obligation of the surety would likewise be void."

In United States v. Marshall, *supra*, the Court stated, referring to a waiver clause on an SBA form, that

"the waiver provisions here are neither authorized by Congressional enactment nor pursuant to SBA powers to issue regulations after appropriate hearings and other administrative proceedings. They are the result merely of the internal drafting of standard form agreements. We believe that policies which affect basic property rights, such as the right of redemption, should be formally adopted after careful consideration with an opportunity for public participation and not by the unilateral action of administrative agencies' staffs."
431 F. Supp at 982.

2. No exception to the General Rules of Guaranty applies here.

The Law of Guaranty recognizes two types of possible exceptions to the General Rule that the Guarantor is discharged when the Principal Debtor is discharged. They are as follows:

- (a) That the Instrument of Guaranty makes the Guarantor a principal or an insurer of the original obligation instead of an accessory.
- (b) That the Guarantor becomes liable by being a party to the terms of the Agreement releasing the Principal and establishing a supplemental liability of the Guarantor.

Neither of these exceptions applies here.

(a) The Guarantors are not principals in, or insurers of, the Beardslee Lumber Company debt to SBA.

The Court referred to the waiver of notice provisions in the Guaranty Agreement concerning collateral, and the fact that the Principal could release the Debtor without giving notice to the Guarantor and without releasing the Guaranty.

These provisions do not change the obligation of the Guarantor, namely, to back up the obligation of the Principal.

It is clear that the Guaranty forms at

issue, SBA Forms 148A and B, do not contemplate original or primary obligation of Petitioners, but rather impose only guaranty liability. The forms are headed "Guaranty" not "Indemnity" or "Insurance". The Petitioners are said to "guarantee the Bank", not insure it. The terms "guaranty" and "guarantors" are repeated throughout the documents.

The Court refers to certain portions of the documents to conclude that Petitioners here have "waived" the "defense" of extinguishment of the principal obligation. Specifically relied upon by the Court are subparagraphs (a) thru (e) purporting to give "the Bank full power . . . to deal in any manner with the liabilities and collateral." However, that "grant of full power" is specifically, by the terms of the documents, "subject to the provisions of any agreement between the Debtor . . . and Bank at the time in force." Was there an agreement between the SBA, assignee of Bank, and Debtor with regard to the debt at the time the SBA sought to enforce the Guaranty? Yes. The SBA had agreed with Principal to extinguish the debt of the Principal. That agreement clearly extinguished the collateral obligation of the Guarantors.

Perhaps the clearest proof of the nature of Petitioners' liability here is found in a paragraph not quoted in the Court's opinion. In the paragraph of the Guaranty's following that quoted by the Court in its opinion (A-18), the Guarantors are required to pay on de-

fault of Debtor "upon written demand of Bank" in like manner as if such amount constituted the direct and primary obligation of the undersigned, "stating that Bank is not required to make demand against the Debtor nor to exhaust the collateral." The obligation of Petitioners therefore was clearly recognized as not being direct and primary for most purposes. The obligation was recognized as collateral and was only to be treated as direct and primary for the limited purposes of relieving the Bank from the common law obligations of demanding payment from the Debtor (but not extinguishing the Debtor's obligations) and exhausting the collateral. If the obligation of the Petitioners here was intended to have been primary and direct for all purposes, the SBA form could easily have so stated.

- (b) The Petitioners (Guarantors) were not parties to the agreements discharging the debt of their principal, Beardslee Lumber Company, or to the agreements discharging the assignee, Freeport Hardwood Corporation.

The second exception to the General Rule is where the Guarantor was a party to an agreement releasing the Debtor and applying Debtor's final payment on the unpaid balance of his obligation. The pleadings and other facts in this case do not connect Guarantors with the agreements discharging their Principal, Beardslee Lumber Com-

pany. Nor does the record show any connection between guarantors and the agreement discharging the debt of Freeport Hardwood Corporation to whom their guaranty had been assigned by Beardslee Lumber Company and others. The second exception to the general rules of guaranty does not apply.

3. Ambiguities and inconsistencies must be construed in favor of Petitioners (Guarantors).

The Court of Appeals found an inconsistency existed in the Guaranty Agreement between the provisions of paragraph 2 and paragraph 3.

"Thus, any language inconsistency between paragraphs two and three is due to the different purposes for which they were intended. When the language of these two paragraphs is read in the context of the facts in this case, it is clear that it is paragraph two and not paragraph three that controls."
(A-9n)

The rule is stated in 11 Callaghan's Michigan Civil Juris., at 485

"It is also a well settled general rule that a contract of guaranty, if uncertain, must be construed against the party who drafted it."
Accord, 13 Mich. Law and Practice at 100.

By their plain terms the documents here were guarantees. The SBA drafted the documents and throughout referred to the documents as guarantees. The SBA specifically provided in the documents that only for certain purposes were they to be treated "as if" they imposed primary liability, recognizing thereby that for all other purposes the liability of Petitioners was secondary and collateral in accord with normal Guaranty Law. As the party who created any ambiguities that might exist, the SBA cannot now be heard to say that the documents were in fact something other than "guarantees" and the liability of Petitioners was something other than secondary.

III. Discharge by Respondent (U.S.) of all Freeport Hardwood Corporation obligations, together with the release and discharge of all security held therefore, discharged all claims against Petitioners.

A. THE AGREEMENT BETWEEN SBA AND FREEPORT HARDWOOD CORPORATION DISCHARGED THE GUARANTEE OF PETITIONERS.

The facts, as recited in the opinion of the Court of Appeals, are conclusive in favor of guarantors on this issue.

1. Beardslee Lumber Company's amendment to its Plan of Arrangement in its Chapter XI proceedings provided for the transfer of its physical assets to

Freeport Hardwood Corporation together with and subject to the security agreements including guarantees in favor of SBA. This transaction is stated in the opinion (A-5) as follows:

"The amendment provided that Beardslee Lumber be permitted to convey by quit-claim deeds its real property and transfer its personal property covered by the SBA mortgages and security agreements, respectively, to Freeport Hardwood. The transfer of real and personal property, however, was made subject to the mortgages, security agreements and guaranties executed in favor of SBA."

2. SBA agreed to discharge the Beardslee Lumber Company security agreements and mortgages on discharge of the Freeport Hardwood Corporation's promissory note.

"As part of the agreement leading to the execution of the promissory note, SBA agreed that upon the payment of the note by Freeport Hardwoods, the security agreements and mortgages against Beardslee Lumber would be discharged." (A-6)

3. A later settlement between the Beardslee Lumber Company and SBA, approved by the Bankruptcy Court in the Reorganization proceedings, discharged all remaining obligations of Beardslee Lumber Company to the SBA.

"The lower court concluded that this stipulation, 'together with a prior stipulation entered into December 8, 1969, had the effect, upon ratification by the referee, of discharging the lumber company of any and all further obligation upon the notes in question.'"

4. After default by Freeport Hardwood Corporation, and start of foreclosure by SBA, the debt was settled and discharged together with the discharge of mortgages and security agreements of both Beardslee Lumber Company and Freeport Hardwood Corporation.

"Furthermore, pursuant to that settlement, SBA discharged the mortgages and security agreements against Beardslee Lumber and Freeport Hardwood. The document discharging Freeport Hardwood states that the indenture of mortgage is 'FULLY PAID, SATISFIED AND DISCHARGED,' whereas, a similar document relating to Beardslee Lumber states

that the indenture of mortgage is 'DISCHARGED'."

There appears to be no clue in either the District Court's opinion or the Sixth Circuit Court's opinion, as to how obligations under the guarantees of Petitioners survived the complete discharge of all SBA obligations against Beardslee Lumber Company, including all security supporting those obligations, and the discharge of all SBA obligations of Freeport Hardwood Corporation including all security given to support those obligations.

We submit that there is no factual or legal basis in the record of this case to support the Respondent's claim that Petitioners' debt under the guarantees remains outstanding.

If full faith and credit were given to the orders of the Bankruptcy Court, as well as on principles of res judicata the Federal Court would have determined that the guarantees of Petitioners ceased to be obligations supporting a debt of Beardslee Lumber Company to SBA, but were transferred to, and supported only, the debt of Freeport Hardwood Corporation to the SBA. The Federal Court should also have found that the order approving the stipulation of the parties cancelling all debts of Beardslee Lumber Company to SBA, struck out and rendered invalid, any ledger account on the books of SBA against Beardslee Lumber Company.

When the SBA acknowledged settlement satisfaction and discharge of all debts of Freeport Hardwood Corporation, and the release and discharge of all mortgages and other security of Beardslee Lumber Company and Freeport Hardwood Corporation which it held to secure the Freeport Hardwood Corporation debt, the guarantee of Petitioners, just as the guarantees on the same forms given by officers of Freeport Hardwood Corporation, were discharged.

B. THE RELEASE OF ALL SECURITY
FOR THE DEBT RELEASED
PETITIONERS AS GUARANTORS.

In addition to the discharge by the agreement between SBA and Freeport Hardwood Corporation, the release and discharge of all security given by Beardslee Lumber Company to SBA, discharged Petitioners under the guarantee agreements.

A generally accepted principle of the Law of Guaranty provides that a Guarantor is released by a change in the agreement between the Debtor and the Creditor which is detrimental to the Guarantor and is given without his consent. When the SBA released and discharged those liens on April 14, 1971, in favor of Freeport Hardwood Corporation, the Guarantors were also discharged even if they had not been discharged by the prior release and discharge of Beardslee Lumber Company, which had been executed by the SBA in

the Chapter XI proceedings.

This principle is stated in 38 C.J.S. Guaranty, at 1250, as follows:

Paragraph 81, Release or Loss
of other Securities.

"As appears in the C.J.S. title Subrogation §47, also 60 C.J. p. 740 note 6, p. 741 note 10, a Guarantor who pays the debt of the Principal Debtor is entitled to be subrogated to whatever rights and collateral security the guarantee held: and for this reason it is well settled that the surrender or release by a Creditor, without the Guarantor's consent, of any security held at the time when the debt is guaranteed will operate as a discharge of the Guarantor to the extent to which he is injured thereby."

See also 38 L.R.A. (N.S.) at 875.

The essence of the Respondent's claim here against Petitioners on their guarantee agreements is an assertion of the right to be paid twice for the same debts, in the face of having executed complete releases to both Beardslee Lumber Company and Freeport Hardwood Corporation for the debts and complete releases on all security given to support the payment of those debts.

CONCLUSION:

Re-cap of the facts:

A Michigan bank (Hastings) loaned funds to a Michigan lumber mill (Beardslee Lumber Company) on promissory notes secured by mortgages on plant and equipment, and guarantees, written on SBA forms, from the corporation's president and his wife (Petitioners). The corporation defaulted and the bank assigned the notes and the security to SBA (U.S.).

Beardslee Lumber Company filed Chapter XI reorganization proceedings in the Bankruptcy Court for the Western District of Michigan, and the Respondent filed secured and priority claims. Thru negotiations between SBA, Beardslee Lumber Company and the Receiver an amendment to the plan of reorganization was approved by the Court pursuant to which the mill and equipment and the mortgages and guarantees were assigned and transferred to Freeport Hardwood Corporation, a new Michigan corporation, which used the security to obtain an SBA loan. Its officers also signed SBA form guarantees. This transaction, discharged Beardslee Lumber Company from all obligations on the security.

By a subsequent transaction between SBA, Beardslee Lumber Company and the Receiver, the priority and preferred claims of SBA against the Beardslee Lumber Company re-organization proceedings, approved by Bankruptcy Court order, were discharged and cancelled.

In the agreement between Freeport Hardwood Corporation and SBA, Petitioners signed as guarantors to acknowledge the transfer of their guarantees from the Beardslee Lumber Company obligation to the Freeport Hardwood Corporation obligation to SBA. After default by Freeport Hardwood Corporation and the filing of a foreclosure suit by Respondent, Freeport Hardwood Corporation obligations were settled and discharged and all mortgages and security interests of both Beardslee Lumber Company and Freeport Hardwood Corporation released and discharged.

Respondent's position in these proceedings is that its claims against Petitioners on their guarantee agreements survived the complete discharge and release on the obligations and security interests which it gave, thru its SBA agency, to both Beardslee Lumber Company and Freeport Hardwood Corporation.

Petitioners' legal conclusions:

1. Petitioners' guarantees were Michigan contracts to be construed by Michigan law.

2. The record provides no basis for the Court of Appeals conclusion that an "overriding federal interest" is present requiring use of Federal law to construe the guarantee agreements.

3. The Court of Appeals erred in holding that a 1974 SBA regulation pro-

vided a substitute for a factual showing of an "overriding federal interest". to avoid the application of Michigan law in interpreting the 1964 and 1967 guarantee agreements.

4. The District Court erred in finding that Petitioners waived the defense of discharge of the principal, when they signed the Guarantee Agreements.

5. The District Court and the Court of Appeals erred in failing to give full force and effect to orders of Bankruptcy Court transferring Beardslee Lumber Company fixed assets and security agreements, including Petitioners' guarantees, to Freeport Hardwood Corporation and discharging Beardslee Lumber Company from all claims of Respondent.

6. The District Court and the Court of Appeals erred in failing to give full force and effect to Respondent's settlement of its foreclosure action discharging Freeport Hardwood Corporation's obligations and releasing and discharging all mortgages and security interests of which Petitioners' guarantees were a part.

The Petition for Certiorari to review the judgment of the Sixth Circuit Court of Appeals, affirming the judgment of the District Court for the Western District of Michigan, should be granted.

DATED: May 19, 1978

FRANK J. BEARDSLEE and
FRANCES M. BEARDSLEE

By Robert C. C. Heaney
Their Attorney
Robert C. C. Heaney
7110 N. Oracle Rd.
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Attorney for
Petitioners

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UNITED STATES of America
Plaintiff-Appellee,

v.

Frank J. BEARDSLEE and Frances M.
Beardslee, wife,

No. 75-2466

United States Court of Appeals,
Sixth Circuit.

Argued April 5, 1977

Decided September 14, 1977

Appeal was taken from judgment of the United States District Court for the Western District of Michigan, Noel P. Fox, Chief Judge, in favor of the Small Business Administration against guarantors of two promissory notes. The Court of Appeals Guy, District Judge, sitting by designation, held that, under guaranty agreement, a SBA form, to effect that obligations of guarantor should not be released, discharged or in any way affected by reason of any action lender might take or omit to take under its powers, including effecting release, compromise or settlement, release of principal debtor did not discharge obligations of guarantors under the agreements.

Affirmed.

Appendix - 1

(Headnotes from 562 Fed. Reporter, 2d Series,
p.1016)

1. Federal Courts 407

Federal law governed issue of liability of guarantors on notes executed by principal obligor in favor of bank and assigned to Small Business Administration before principal obligor filed for Chapter XI arrangement under the Bankruptcy Act. Bankr. Act, §301 et seq., 11 U.S.C.A. §701 et seq.

2. Guaranty 92(1)

Where language of SBA form, a guaranty agreement, was clear and unambiguous on its face, interpretation of it was question of law.

3. Guaranty 35

Although guaranty agreements indicated signers were acting as guarantors of principal debt, that alone would not preclude them from being held principally liable on promissory notes.

4. Guaranty 72

Under guaranty agreement, a SBA form, to effect that obligations of guarantor should not be released, discharged or in any way affected by reason of any action lender might take or omit to take under its powers, including effecting release, compromise or settlement, release of principal debtor did not discharge obligations of guarantors under such agreements.

Where guaranty agreements were placed in evidence and interpreting language of them was integral part of court's task in rendering decision, court's interpretation of agreements in manner and on basis not urged by either party was not reversible error, but rather was within court's decision

Robert C. C. Heaney, Tucson, Ariz., for defendants-appellants.

Frank S. Spies, U.S. Atty., Grand Rapids, Mich., William Kanter, Edwin Huddleson III Morton Hollander, Harland F. Leathers, Civ. Div., App. Section, Dept. of Justice, Washington, D.C., for plaintiff-appellee

Before PHILLIPS, Chief Judge, CELEBREEZE, Circuit Judge, and GUY*, District Judge.

GUY, District Judge.

This is an appeal from a judgment in favor of the Small Business Administration (SBA) against guarantors of two promissory notes. The notes were executed by Beardslee Lumber Company, the principal obligor, in favor of National Bank

* Honorable Ralph B. Guy, Jr., United States District Judge, for the Eastern District of Michigan, Southern Division, sitting by designation.

of Hastings and were guaranteed by defendants, Frank J. and Frances M. Beardslee, Subsequent to the notes being assigned to SBA, the principal obligor filed for a Chapter XI arrangement under the Bankruptcy Act, 11 U.S.C. §701 et seq. Following a series of complicated transactions and negotiations leading to the discharge of the principal obligor, SBA commenced this action against the defendants as guarantors of the notes for the amount that had not been paid prior to the discharge of the principal obligor.

Beardslee Lumber executed two promissory notes on October 22, 1964 and May 3, 1967 for \$140,000 and \$120,000 respectively. In addition to the guaranties signed by defendants, the two promissory notes were secured by mortgages on the real estate and security agreements covering machinery and equipment of Beardslee Lumber situated in Freeport, Michigan. On January 30, 1968, the National Bank of Hastings assigned to SBA the aforementioned notes and related mortgages and security agreements, including the Guaranty Agreements signed by defendants.

After the notes were in default and maturity accelerated as provided by their terms, SBA submitted to the principal obligor demand letters on February 5, 1968, demanding payment of the full amount of the notes. Payment was not forthcoming. At approximately the same time, Beardslee Lumber filed a petition for an arrangement under Chapter XI of

the Bankruptcy Act, 11 U.S.C. §722.¹ SBA filed proof of secured and priority claims based upon its two promissory notes and also listed the mortgages and security agreements as security for its claims. Beardslee Lumber filed a Plan of Arrangement pursuant to Chapter XI on April 26, 1968, which was accepted by order of the Bankruptcy Court on June 3, 1968.

Subsequently, on May 1, 1969, following negotiations between Freeport Hardwood Corporation, SBA, Beardslee Lumber and Marshall B. Kindy, Receiver in Bankruptcy for Beardslee Lumber, Beardslee Lumber filed an amendment to its Plan of Arrangement. The amendment provided that Beardslee Lumber be permitted to convey by quit-claim deeds its real property and transfer its personal property covered by the SBA mortgages and security agreements, respectively, to Freeport Hardwood. The transfer of real and personal property, however, was made subject to the mortgages, security agreements and guaranties executed in favor of SBA. The transfer agreement also provided that Freeport Hardwood shall secure from SBA a release and discharge of Beardslee Lumber

1. §722 provides: "If no bankruptcy proceeding is pending, a debtor may file an original petition under this chapter with the court which would have jurisdiction of a petition for his adjudication."

from all mortgages and security agreements executed in favor of SBA; however, such release and discharge was without prejudice to any priority or unsecured claims SBA might have against Beardslee Lumber.

As a result of the aforementioned transaction, Freeport Hardwood, on September 9, 1969, executed a promissory note for \$126,921.96 to the SBA. This amount was credited to the account of Beardslee Lumber as partial satisfaction of the indebtedness owed SBA. The Freeport Hardwood promissory note was secured by a real estate mortgage, security agreement on personal property and guaranties signed by officers of Freeport Hardwood similar to those executed by defendants. As part of the agreement leading to the execution of the promissory note, SBA agreed that upon the payment of the note by Freeport Hardwood, the security agreements and mortgages against Beardslee Lumber would be discharged. The amendment to the Plan of Arrangement filed by Beardslee Lumber encompassing its agreement with Freeport Hardwood was approved by the Bankruptcy Court by order signed June 9, 1969.

Chronologically, the next event that occurred was a Stipulation for Settlement of Claims of the SBA filed May 20, 1970, which was approved by the Bankruptcy Court on June 22, 1970. This stipulation involved the disbursement of settlement proceeds resulting from certain litigation pending at the time Beardslee Lumber filed its petition for arrangement. Marshall B. Kindy,

as receiver for Beardslee Lumber, became a participant in that litigation as a party defendant. Settlement proceeds amounted to \$25,000. Of this amount \$15,000 was paid for attorney's fees; \$5,000 was turned over to the receiver; and the remaining \$5,000 was given to SBA: "to settle all its claims priority or otherwise, against the above named debtor, which have not been previously settled." The lower court concluded that this stipulation, "together with a prior stipulation entered into December 8, 1969, had the effect, upon ratification by the referee, of discharging the lumber company of any and all further obligation upon the notes in question."

On February 5, 1971, Freeport Hardwood defaulted on its promissory note executed to SBA, and, as a result, suit was commenced for foreclosure of the mortgage and security agreements securing the note for deficiency judgment on the remaining balance. Freeport Hardwood and the guarantors of the promissory note, Fred L. and Shirley Esslair, settled that lawsuit for \$90,000. Furthermore, pursuant to that settlement, SBA discharged the mortgages and security agreements against Beardslee Lumber and Freeport Hardwood. The document discharging Freeport Hardwood states that the indenture of mortgage is "FULLY PAID, SATISFIED AND DISCHARGED," whereas, a similar document relating to Beardslee Lumber states that the indenture of mortgage is "DISCHARGED."

SBA then demanded from defendants payment under their Guaranty Agreements to satisfy amounts which had not been paid as a result of the principal obligor's discharge of the \$120,000 and \$140,000 promissory notes. Following defendants' refusal to pay, the SBA instituted this litigation. In answer to SBA's claim of liability, appellants argued that under general principles of guaranty law the release and discharge of the principal obligor served to release and discharge their guaranty agreements. The SBA on the other hand argued that this defense was not available to defendants because of Section 15 of the Bankruptcy Act, 11 U.S.C. §34, which provides that "the liability of a person who is a co-debtor with, or guarantor or in any manner a surety for, a bankrupt shall not be altered by the discharge of such bankrupt." Upon the filing of a Motion for Summary Judgment by SBA, the parties stipulated that the case be submitted for decision on the merits under the motion on the basis of the briefs filed and arguments made by the parties and the other records and exhibits then before the court.

The trial court, in concluding that the defendants were liable under the Guaranty Agreements, rejected the arguments advanced by both parties and supported its decision on the following basis:

The more serious question is whether the language of the guaranty waives the defense

of a complete release of the principal debtor by the creditor or holder. In the court's opinion it does.

Thus, the lower court held that the language of the Guaranty Agreement, irrespective of the general rules of guaranty law, precluded the appellants' defense of discharge of the principal debtor on an action on the Guaranty Agreement. The court left the issue of damages for further hearing or stipulation by the parties.

On the issue of damages, a stipulation was filed by the parties in which it was agreed that the SBA statement of account for the two promissory notes received from Beardslee Lumber accurately reflected as of a certain date the payments received on such notes. The stipulation further noted that no separate account had ever been carried by the SBA for the defendants. The defendants reserved their right to appeal from the lower court ruling.

After entry of judgment, defendants appealed the adverse ruling of the lower court claiming three points of error: 1) The Guaranty Agreements involved herein, SBA Form 148, do not waive the defense of the discharge of the principal debtor; 2) SBA did not sufficiently prove its damages against appellants, but only established proof of SBA accounts as to Beardslee Lumber, and 3) the lower court was precluded

from resting its decision on waiver because neither party raised this issue before the court in their arguments or pleadings. Plaintiff responded by claiming that the lower court's decision was correct and that the Guaranty Agreement defendants had signed waived any defense otherwise available relative to the discharge of the principal obligor. In addition, plaintiff strenuously reiterates the argument raised in and rejected by the lower court that Section 16 of the Bankruptcy Act precludes defendants from raising the discharge of the principal obligor as a defense to this action.

The lower court relied heavily on paragraph two of the Guaranty Agreements in finding that the defendants had waived their defense of discharge of the principal obligor:

The undersigned waives any notice of the incurring by the Debtor at any time of any of the Liabilities, and waives any and all presentment, demand, protest or notice of dishonor, nonpayment, or other default with respect to any of the liabilities and any obligation of any party at any time comprised in the collateral. The undersigned hereby grants to Bank full power, in its uncontrolled discretion and without notice to the undersigned, but subject to the provisions of any agreement between the Debtor or any other party and Bank at the time in force, to deal in any manner with the Liabilities and the collateral, including, but without limiting the generality of the foregoing, the following powers:

(a) To modify or otherwise change any terms of all or any part of the Liabilities or the rate of interest thereon . . . to grant any extension or renewal thereof or any other indulgence with respect thereto, and to effect any release, compromise or settlement with respect thereto.

(d) To consent to the substitution, exchange, or release of all or any part of the collateral, whether or not collateral if any, received by Bank upon any such substitution, exchange, or release shall be of the same or of a different character or value than the collateral surrendered by Bank;

The obligations of the undersigned hereunder shall not be released, discharged or in any way affected, nor shall the undersigned have any rights or recourse against Bank, by reason of any action Bank may take or omit to take under the foregoing powers.

Although the defendants concede that this paragraph grants the bank and its assigns (SBA) "full power . . . to deal in any manner with the liabilities and collateral . . .," defendants contend that this power is "subject to the provisions of any agreement between the Debtor or any other party and Bank at the time in force." It is the defendant-guarantor's position that there was an agreement in force whereby SBA agreed with the principal obligor to extinguish the debt of the principal and that this agreement also extinguished the obligation of the appellants in this

case.

Moreover, defendants, in attacking the lower court's decision, also refer to paragraph three of the Guaranty Agreement:

In case the Debtor shall fail to pay all or any part of the Liabilities when due, whether by acceleration or otherwise, according to the terms of said note, the undersigned, immediately upon the written demand of Bank, will pay to Bank the amount due and unpaid by the Debtor as aforesaid, in like manner as if such amount constituted the direct and primary obligation of the undersigned. Bank shall not be required, prior to any such demand on, or payment by, the undersigned, to make any demand upon or pursue or exhaust any of its rights or remedies against the Debtor or others with respect to the payment of any of the Liabilities, or to pursue or exhaust any of its rights or remedies with respect to any part of the collateral. The undersigned shall have no right to subrogation whatsoever with respect to the Liabilities or the collateral unless and until Bank shall have received full payment of all the Liabilities.

On the basis of this paragraph, defendants argue that they were to be treated as directly and primarily liable on the principal debt only for the purpose

of relieving the Bank from the requirements to first demand payment from the principal obligor and to exhaust the collateral before seeking payment from the guarantors.

Plaintiff argues that the District Court's interpretation of the Guaranty Agreements is a correct one based on the clear and express language contained in the agreements and, furthermore, that such an interpretation is supported by substantial case precedent.

Before proceeding further, it is incumbent upon this court to ascertain what law should be applied in interpreting these Guaranty Agreements. Courts interpreting this Guaranty Agreement, SBA Form 148, have varied considerably in the choice of law applied in establishing the rights and obligations created thereunder.

Some Courts have considered it necessary to look to state guaranty law, United States v. Krocma, 318 F.Supp. 148, 151 (D.Md. 1970), and United States v. Vince, 270 F.Supp. 591, 594 (E.D.La.1967) or federal law, United States v. Dubrin, 373 F.Supp. 1123, 1125 (W.D.Tex.1974), or both state and federal law, Austad v. United States, 386 F.2d 147, 149 (9th Cir. 1967), while other decisions have ignored state or federal law in favor of the clear language of the guaranty agreement. United States v. Proctor, 504 F.2d. 954, 957 (5th Cir 1974), United States v. Newton Live-stock Auction Market, Inc.,

336 F.2d 673 (10th Cir. 1964), and United States v. Immordino, 386 F.Supp. 611, 615 (D.Colo.1974). In Clearfield Trust Company v. United States, 318 U.S. 363, 63 S.Ct. 573, 87 L.Ed. 838 (1942), the Supreme Court concluded that under some circumstances federal rather than state law applies to disputes of this nature. Controversies involving the United States Treasury and the rights and duties of the United States on commercial paper, the Court concluded, dealt, with a federal interest of sufficient magnitude to dictate that federal law should govern the rights and obligations of the parties. In rejecting reliance on state law in determining liability of a party paying on a forged endorsement of a check drawn on the United States Treasury, the court noted that "the authority to issue the check had its origin in the Constitution and the statutes of the United States and was in no way dependent upon the laws of Pennsylvania or of any other state." Id. at 366, 63 S.Ct. at 575. However, the underlying rationale for the Court's holding that federal law should apply was even more basic:

The application of state law, even without the conflict of laws rules of the forum, would subject the rights and duties of the United States to exceptional uncertainty. It would lead to great diversity in results by making identical transactions subject to the vagaries of the laws of the several states.

The desirability of a uniform rule is plain. Id. at 367, 63 S.Ct. at 575.

Subsequently, in United States v. Yazell, 382 U.S. 341, 86 S.Ct. 500, 15 L.Ed.2d 404 (1966), the Supreme Court was called upon to decide whether the state coverture law of Texas should apply to a loan made by the Small Business Administration. The SBA negotiated a loan to Mr. and Mrs. Yazell. After the Yazells defaulted on a loan, SBA foreclosed and brought suit for a deficiency judgment. When the SBA sought to satisfy the deficiency with Mrs. Yazell's personal and separate property, the defense was raised that under Texas law a married woman could not bind her separate property unless she had first obtained a court decree removing her disability to contract. No such decree had been obtained. The Court concluded that the government's interest in collecting the moneys it has lent is not a sufficient "federal interest" to override the application of state coverture law under the doctrine enunciated in Clearfield Trust, supra. However, the Court reaffirmed the Clearfield Trust doctrine that federal law may supersede state law where federal programs and actions "by their nature are and must be uniform in character throughout the Nation." Id. at 354, 86 S.Ct. at 507. The Court stopped well short of holding that state law applies under all circumstances to loans negotiated by the SBA:

We decide only that this Court, in the absence of specific congressional action, should not decree in this situation that implementation of federal interest requires overriding the particular state rule involved here. Both theory and the precedents of this Court teach us solicitude for state interests, particularly in the field of family and family-property arrangements. Id. at 352, 86 S.Ct. at 507.

Thus, it was left to an individual case-by-case analysis to determine the presence and sufficiency of a "federal interest" in the enforcement of loans negotiated by the SBA. Clearly, the Court's holding in Yazell did not forever preclude the application of federal law to SBA negotiated loans.

Recently, this circuit has held, relying on administrative regulation 13 C.F.R. §101.1(d), that the Michigan law of coverture does not apply to the enforcement of a SBA loan. United States v. Lowell, 557 F.2d 70 (6th Cir. 1977).

2. Not only may congressional action manifest a "federal interest" sufficient to override state law, but the Court also noted that agency regulations may serve a similar function: "We do not here consider the question of the constitutional power of the Congress to override state law in these circumstances by direct legislation or by appropriate authorization to an administrative agency coupled with suitable implementing action by the agency." (Footnotes omitted) Id. at 352, 86 S.Ct. at 506.

The Lowells had acted as guarantors of a loan executed by the SBA. After the principal obligor defaulted on the loan, a judgment was entered against the guarantors. Although the United States had not yet sought to execute on its judgment against the separate property of Mrs. Lowell, the appellants raised the issue on appeal. In order to expedite resolution of this issue, this court decided that the Michigan law of coverage does not apply to the execution of judgment on a loan by the SBA. In reaching this conclusion, reliance was primarily placed on the "federal interest" manifested in regulation 13 C.F.R. §101.1(d), promulgated pursuant to congressional authority, 15 U.S.C. §634, which provides:

Applicable law. (1) Loans made by SBA are authorized and executed pursuant to Federal programs adopted by Congress to achieve national purposes of the U.S. Government.

(2) Instruments evidencing a loan, obligation of security interest in real or personal property payable to or held by the Administration or the Administrator, such as promissory notes, bonds, guaranty agreements, mortgages, deeds of trust and other evidences of debt or security shall be construed and enforced in accordance with applicable Federal law.

Thus, in Lowell, the "federal interest" which the Supreme Court found lacking in Yazell had been satisfied by the prom-

ulgation of the aforementioned regulation by the SBA under authority of Congress.

[1] On the basis of our holding in Lowell, the SBA regulation cited, and the Clearfield Trust doctrine, we conclude that federal law should also apply in the resolution of the issue before us in this case. Whether the "federal interest" manifested in the SBA regulation will always be sufficient to override state law in the interpretation and enforcement of SBA loans is a question we are not required to reach, however, it would appear that future application of state law to SBA loans will face more stringent analysis and scrutiny in light of the "federal interest" found in this case and in Lowell.

3. In another case decided by this circuit, Weinstein v. United States, 511 F.2d 56 (6th Cir.1975), it was held that compliance with state law did not interfere with a federal interest and thus applied state law. The state law of Ohio governed the validity of a waiver of notice provision in the guaranty agreement with respect to the sale of collateral pledged by the debtor to secure the loan. It should be noted, however, at the time Weinstein was decided, the regulation manifesting "federal interest" in the interpretation and enforcement of SBA loans was only two months old and it is likely that it was not brought to the attention of the court at that time.

[2] In determining the substantive content of the federal law applicable to this case, the court is faced with no federal appellate and only one federal district court decision dealing with the issue presented here. Moreover, in light of the conclusion reached that federal law applies, the one federal district case, United States v. Krochmal, *supra*, is inapposite since it rested its decision on the basis of Maryland and District of Columbia law. Thus, this court is faced with the task of formulating a federal rule of law where no relevant federal precedent exists. In the instant case, we find the language of SBA Form 148 clear and unambiguous on its face, United States v. Proctor, *supra*; United States v. Newton Livestock Auction Market, Inc., *supra*; and United States v. Immordino, *supra*, and therefore, interpretation of the agreement is a question of law.

[3] Although the Guaranty Agreements signed by defendants indicate defendants are acting as guarantors of the principal debt, there is nothing from this fact alone that would preclude these appellants from being held principally liable on the promissory notes. Walter Lambert Pharmaceutical Co. v. Sylk, 348 F.Supp. 1039 (E.D.Pa. 1971), and Bank of Italy National Trust and Savings Asso. v. Symmes, 118 Cal.App.716, 5 P.2d 956, 958 (1931). See also, Restatement of the Law, Security (1944), §82(g), pp. 231-32.

Numerous state court decisions dealing

with the continued liability of guarantors after discharge of the principal obligor have held that the discharge of the principal obligor does not relieve the guarantor of liability where the right of recourse against the guarantor is expressly reserved in the contract releasing or discharging the principal obligor, Bank of Italy National Trust & Savings Asso v. Symmes, *supra*, (statutory basis); Lilenquist Motors, Inc. v. Monk, 64 Wash.2d 187, 390 P.2d 1007 (1964), (partial discharge); Continental Bank & Trust Co. v. Akwa, 58 Wis.2d 376, 206 N.W.2d 174 (1973), or in the guaranty contract. Coghlin v. Smith, 163 Wash. 290, 1 P.2d 215 (1931); Fruehauf Trailer Company of Canada, Ltd. v. Chandler, 67 Wash.2d 704, 409 P.2d 651 (1966); Warner Lambert Pharmaceutical Co. v. Sylk, *supra*; United States v. Krochmal, *supra*, and Restatement of the Law, Security (1941) §122, at 322.

4. The court, faced with very similar language in the guaranty agreement as found in the instant case, concluded;

In clear and unambiguous terms, the guaranty agreement waived the defense of release or discharge by providing that 'The liability of the undersigned * * * shall not be affected * * * by the discharge or release of any obligation PIX.' We hold that the quoted provision of the agreement constituted a full and complete waiver by the guarantors of the defense that the principal obligation had been discharged. *Id.* at 654.

[4] In Krochmal, supra, at 151, in interpreting the same SBA Form 148 as involved in this case, the federal district court found that the laws of Maryland and the District of Columbia provided that the language of Form 148 "amounted to a consent by the guarantors that the release of the principal debtor did not discharge the guarantors." Although no decisions have applied federal law in reaching this result, we conclude that federal law should embody the construction of this language in Form 148 that was made in Krochmal. Based on a reasonable interpretation of the clear and unambiguous language contained in Form 148, we conclude that as a matter of federal law the release of the principal debtor did not discharge the obligation of the guarantors under this agreement.

The arguments advanced to this court by the defendants for a contrary result are not persuasive. Contained as part of the "full powers" granted the guarantee in the Guaranty Agreement is the power to "deal in any manner with the Liabilities and the collateral, including, but without limiting the generality of the foregoing, the following powers: '(a) . . . to effect any release, compromise or settlement with respect thereto [Liabilities].'" There is no merit to the appellants' argument that the aforementioned guarantee's "full power" which is "subject to the provision of any agreement between the Debtor . . . and Bank at the time in force" was thereby limited by the discharge between

Beardslee Lumber and SBA because such discharge was an agreement by the debtor limiting the guarantee's otherwise "full power" to effectuate a release or settlement of the debtor's liability. Such a construction of this Guaranty Agreement would render a nullity to subsection (a) of paragraph two of the agreement because any release, compromise, or settlement will be accomplished by agreement with the debtor. The limiting provision in the Guaranty Agreement cited by defendants relating to "any agreement between the Debtor . . . and the Bank . . ." must be interpreted to relate only to agreements by the debtor and guarantee limiting the otherwise "full power" of the guarantee to deal with the liabilities and collateral vis-a-vis the debtor, and these limitations, in turn, would apply to restrict the otherwise "full power" the guarantee would have against the guarantors. The discharge agreement between the guarantee (SBA) and the principal obligor in the instant case in no way was intended to limit the "full power" of the guarantee under the Guaranty Agreement; rather, the agreement between the debtor and SBA was in effectuation of the guarantee's "full power". It would be anomalous result if a debtor's agreement in effectuation of the Guaranty Agreement served to limit the guarantee's rights under the same Guaranty Agreement. Such an interpretation is not reasonable nor could it have been within the intention of the parties involved.

In light of the construction given by the court to paragraph two of the Guaranty Agreement, defendants' interpretation of paragraph three of the same agreement becomes inconsistent and untenable. Paragraph three deals with those circumstances where the principal obligor has defaulted on its loan and an amount remains "due and unpaid by the Debtor." Paragraph two deals with the situation where the guarantee has decided to effectuate a release, compromise or settlement with respect to the liabilities or collateral of the debtor. Thus, any language inconsistency between paragraphs two and three is due to the different purposes for which they were intended. When the language of these two paragraphs is read in the context of the facts in this case, it is clear that it is paragraph two and not paragraph three that controls.

In addition, plaintiff asserts another reason for affirmance of the district court's decision. Based upon Section 16 of the Bankruptcy Act, 11 U.S.C. §34 supra, plaintiff argues that the discharge of Beardslee Lumber ratified in the bankruptcy proceeding does not alter the liability of defendants. The district court rejected plaintiff's Section 16 argument, finding that Beardslee Lumber's discharge was not by order of the bankruptcy court, but by express agreement with the creditor. In this regard, the court concluded that the agreement to discharge the debtor was only ratified by the referee in bank-

ruptcy, but that this did not constitute a discharge in bankruptcy and, thus not within the purview of Section 16. In light of the Court's ruling that defendants are not released from their obligation as guarantors as a result of the discharge of the principal obligor, it is not necessary for us to treat additionally the Section 16 issue raised by plaintiff.

The Court finds no merit in defendants' other two claims of error. Proof of unpaid amounts on the account of Beardslee Lumber was sufficient to establish damages under the Guaranty Agreements, in light of the court's previous discussion, even though Beardslee Lumber was discharged from those debts.

[5] Also, the lower court did not err in relying on the contract waiver issue for its decision. The Guaranty Agreements had been placed in evidence and interpreting the language of such agreements was an integral part of the court's task in rendering a decision. The district court's interpretation of the agreements in a manner and on a basis not urged by either party is not reversible error, but, rather, is within the discretion of a court faced with an interpretation of a written agreement.

The Judgment of the District Court is Affirmed.

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

No. 75-2466

UNITED STATES OF AMERICA,

Plaintiff-Appellee,

v.

FRANK J. BEARDSLEE and
FRANCES M. BEARDSLEE, his wife,

Defendants-Appellants.

Before: PHILLIPS, Chief Judge,
CELEBREZZE, Circuit Judge, and GUY,
District Judge.

J U D G M E N T

APPEAL from the United States District
Court for the Western District of
Michigan.

THIS CAUSE came on to be heard on the
record from the United States District
Court for the Western District of
Michigan and was argued by counsel.

ON CONSIDERATION WHEREOF, It is now
here ordered and adjudged by this Court
that the judgment of the said District
Court in this cause be and the same is
hereby affirmed.

It is further ordered that plaintiff-

appellee recover from defendants-appel-
lants the costs of appeal, as itemized
below, and that execution therefor issue
out of said District Court if necessary.

ENTERED BY ORDER OF THE
COURT.

/s/ John D. Hehman

(Filed September 14, 1977)
(Issued as amend mandate - March 16, 1978)

Costs: To be recovered by Appellee

Filing Fee\$

Printing\$ 159.95

Total \$ 159.95

No. 75-2466

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

UNITED STATES OF AMERICA,)
)
Plaintiff-Appellee,)
)
v.)
)
FRANK J. BEARDSLEE and) ORDER
FRANCES M. BEARDSLEE,)
his wife,)
)
Defendants-Appellants.)
_____)

Before PHILLIPS, Chief Judge,
CELEBREZZE, Circuit Judge, and GUY,
District Judge

No judge of the court having made a
motion for rehearing en banc, the peti-
tion for rehearing has been assigned to
the hearing panel.

Upon consideration, the court con-
cludes that the petition for rehearing
is without merit. Accordingly, it is
ORDERED that the petition for rehearing
be and hereby is denied.

Entered by order of the court.

/s/ John P. Hehman

(Filed February 21, 1978)

Appendix - 12

UNITED STATES DISTRICT COURT
FOR THE
WESTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION
GRAND RAPIDS

United States of America,
Plaintiff,

v. File G-157-71-CA
Frank J. Beardslee and
Frances M. Beardslee,
his wife,
Defendants.

O P I N I O N

This suit was instituted by the United
States against Frank J. Beardslee and
Frances M. Beardslee, his wife, to re-
cover the balance due on two promissory
notes, dated October 22, 1964 and May 3,
1967 in original principal amounts of
\$140,000 and \$120,000, respectively.
The notes were executed by Beardslee
Lumber Company, a Michigan corporation,
and made payable to the order of the
National Bank of Hastings.

Frank J. Beardslee was president of
the Beardslee Lumber Company and executed
the notes on behalf of the corporation.
On the same dates, Beardslee and his
wife executed in connection with the loan

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their personal guarantee upon the appropriate SBA form in effect at the time.

On January 30, 1968 the National Bank of Hastings assigned to the SBA both notes and accompanying guarantees. Thereafter, on February 5, 1968 the SBA made demand for immediate payment by defendants of the outstanding balance, the notes being then in default and maturity having been accelerated. This suit followed, in which the foregoing facts were alleged, and in general admitted. Defendants raise as a defense to this action that as guarantors of the notes, they were released from liability by virtue of a settlement and complete release given Beardslee Lumber Company by the SBA in the process of Chapter XI proceedings, in which the lumber company was the debtor. On that state of the pleadings, the United States moved for summary judgment, and a hearing on the motion was followed by a stipulation entered into by the parties submitting the entire case for decision on the merits based upon the record, admissions, exhibits then before the court, leaving open only the question of damages, should the government prevail.

While the negotiations and matters in dispute were more complicated, suffice it to say for the purposes of this litigation that on May 22, 1970 there was filed in the Chapter XI proceedings a stipulation, executed by the SBA, the Debtor, and the Receiver, which together with a prior stipulation entered into December 8, 1969, had the effect, upon

ratification by the referee, of discharging the lumber company of any and all further obligation upon the notes in question. No mention was made of any discharge of defendants as guarantors of the note. Such ratification was effected by order of the referee filed in the arrangement proceedings on June 22, 1970.

Each party agrees with the general principles of law relied upon by the other, but claims they are inapplicable under the facts here.

The government claims that the Bankruptcy Act expressly provides that a guarantor is not released by the discharge of the bankrupt:

"The liability of a person who is a co-debtor with or guarantor or in any manner a surety for, a bankrupt shall not be altered by the discharge of such bankrupt." 11 U.S.C. 34.

The government cites U.S. v. Anderson, 366 F.2d 569 (10th Cir 1966) as express authority that the cited provision of the statute applies to Chapter XI proceedings, and beyond that to SBA-type guarantees.¹

On the other hand, defendants claim

¹ Actually U.S. v. Anderson, supra, involved Chapter X proceedings and was directed primarily to questions not in issue here.

that discharge in bankruptcy is not involved here but rather an agreement between the SBA and the debtor to release the latter without the consent of the defendants as guarantors, thus bringing into operation the general rule of law that ". . . if the creditor has given the principal debtor an unconditional release of liability, the underlying obligation has been satisfied and the guarantor is no longer liable on his guaranty." 38 Am. Jur. 2d p. 1085.

Defendants further rely upon the general principle of law that a material alteration in the principal contract, made without the consent of the guarantor discharges the guarantor if the material alteration injures the interest of the guarantor. 38 Am. Jur. 2d, page 1088.

Under the facts here, the court must agree with defendants that involved here is not the discharge of the debtor by bankruptcy, but rather by express agreement with the creditor, although ratified by the referee in bankruptcy. The real question, as the court here sees it, is (a) whether a guarantor can, by the express written terms of his guaranty, waive the defense of discharge and release of the principal, or of material alteration of the obligation guaranteed, and (b) if so, whether he has done so here. (See Guarantee, 38 Am. Jur. 22 §74 and McCarthy Foundation v. Winshall, 372 Mich 389 (1964).

Although no mention of the question of waiver of defense is expressly made by either side, the court is satisfied

that no rule of law or public policy forbids it, at least absent any other factor not apparent here. The only question remaining, therefore, is whether, assuming they could, the defendants have in fact waived application of the defenses they now assert. The answer must necessarily lie in the expressed provisions of the guaranty which defendants signed and which is basically a contract between defendants and the creditor to whom the contract benefits have been assigned. See First National Bank v. Chevrolet Co., 270 Mich 116 (1935).

The document relied upon by the government (Exhibit 5 attached to the complaint and admitted in the answer) is entitled "Guaranty". It recites that in order to induce the bank to make a loan to the lumber company, the defendants "hereby unconditionally guarantees to Bank, its successors and assigns, the due and punctual payment when due, whether by acceleration or otherwise", of the amounts due under the note guaranteed.

It further provides that such note, and the interest thereon and "all other sums payable with respect thereto are hereinafter collectively called 'Liabilities'".

Paragraph 2 of the note provides as follows:

The undersigned waives any notice of the incurring by the Debtor at any time of the Liabilities, and waives any and all presentment, demand, protest or notice of dishonor, nonpayment or other default with respect to any of the Liabilities and any obligation of any party at any time comprised in the collateral. The undersigned hereby grants to Bank full power, in its controlled discretion and without notice to the undersigned but subject to the provisions of any agreement between the Debtor or any other party and Bank at the time in force, to deal in any manner with the Liabilities and the collateral, including, but without limiting the generality of the foregoing, the following powers:

(a) To modify or otherwise change any terms of all or any part of the Liabilities or the rate of interest thereon (but not to increase the principal amount of the note of the Debtor to Bank) to grant any extension or renewal thereof and any other indulgence with respect thereto, and to effect any release, compromise or settlement with respect thereto.

(b) To enter into any agreement of forbearance with respect to all or any part of the Liabilities, or with respect to all or any part of the collateral, and to change the terms of any such agreement;

(c) To forbear from calling for additional collateral to secure any of the Liabilities or to secure any obligation comprised in the collateral;

(d) To consent to the substitution, exchange, or release of all or any part of the collateral, whether or not the collateral, if any, received by Bank upon any such substitution, exchange, or release shall be of the same or of a different character or value than the collateral surrendered by Bank;

(e) In the event of the nonpayment when due, whether by acceleration or otherwise, of any of the Liabilities, or in the event of default in the performance of any obligation comprised in the collateral, to realize on the collateral or any part thereof, as a whole or in such parcels or subdivided interests as Bank may elect, at any public or private sale or sales, for cash or on credit or for future delivery, without demand, advertisement or notice of the time or place of sale or any adjournment thereof (the undersigned hereby waiving any such demand, advertisement and notice to the extent permitted by law), or by foreclosure or otherwise, or to forbear from realizing thereon, all as Bank in its uncontrolled discretion may deem proper, and to purchase all or any part of the collateral for its own account at any such sale or foreclosure, such powers to be exercised

only to the extent permitted by law.

The obligations of the undersigned hereunder shall not be released, discharged or in any way affected, nor shall the undersigned have any rights or recourse against Bank, by reason of any action Bank may take or omit to take under the foregoing powers.

From the foregoing it will clearly be seen that the provisions of the guaranty relating to disposal of collateral clearly permits what was done here. The more serious question is whether the language of the guaranty waives the defense of a complete release of the principal debtor by the creditor or holder. In the court's opinion it does: "The undersigned hereby grants to Bank full power . . . to deal in any manner with the Liabilities and the collateral, including, but without limiting the generality of the foregoing, the following powers:
... (a) ...

to effect any release, compromise or settlement with respect thereto . . .

(d) To consent to the substitution, exchange, or release of all or any part of the collateral, whether or not the collateral, if any, received by Bank upon any such substitution, exchange, or release shall be of the same or of a different character or value than the collateral surrendered by the Bank ... " Immediately following the cited paragraph it is provided that:

" The obligation of the undersigned SHALL NOT BE RELEASED, DISCHARGED OR IN ANY WAY AFFECTED, . . . BY REASON OF ANY ACTION BANK MAY TAKE OR OMIT TO TAKE UNDER THE FOREGOING POWERS. " (Emphasis added)

From the foregoing, the court is persuaded that under the admitted and stipulated facts of this case, the guarantys signed by defendants and sued upon here are enforceable by the government and summary judgment in favor of plaintiff will enter, with hearing on damages to be held at a later date to be set by the court if not agreed upon meanwhile.

/s/ Albert J. Engel
District Judge

Dated: October 10, 1972

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UNITED STATES OF AMERICA
IN THE UNITED STATES DISTRICT COURT FOR
THE WESTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION

UNITED STATES OF AMERICA,)
)
Plaintiff,) No. G-157-71 CA 1
)
v.) STIPULATION
)
FRANK J. BEARDSLEE and)
FRANCES M. BEARDSLEE, his)
wife,)
)
Defendants.)
-----)

It is hereby stipulated and agreed by and between the plaintiff, the United States of America, and the defendants, Frank J. Beardslee and Frances M. Beardslee, by their respective attorneys, that a final judgment may be entered forthwith against the above-named defendants, and to provide the Court with a basis upon which to enter that judgment, the parties further stipulate and agree as follows:

1. The certified statement of account from the Small Business Administration for loan numbers SBLP-382-256-00 and L-709-619-00 respectively, attached hereto as Exhibits 1a and 2a, accurately reflect the computation from the SBA ledger sheets for the Beardslee Lumber Company account as of July 24, 1975.

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2. The transcripts of account from the Small Business Administration for loan numbers SBLP-382-256-00 and L-709-619-00 respectively, attached hereto as Exhibits 1b and 2b, accurately reflect as of March 18, 1974, the payments received on such loans and the method by which those payments were credited on said loans by the Small Business Administration.

3. No separate account has ever been carried by the SBA for the loans indicated by the above-noted loan numbers for defendants Frank J. Beardslee and/or Frances M. Beardslee, his wife.

4. Defendants, Frank J. Beardslee and Frances M. Beardslee, his wife, by entering the instant stipulation, in no manner waive their position that they are not either jointly or severally liable under the guaranties at issue in the instant case and specifically preserve their right to appeal from the finding of the liability on such guaranties.

FRANK J. SPIES

Dated:
August 6, 1975

BY

Hugh Warren Brenneman
Assistant United
States Attorney
Attorneys for
Plaintiff

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SCHMIDT, HEANEY,
HOWLETT & VAN'T HOWF

BY
R.C. C. Heaney
Attorneys for
Defendants

Dated: August 11, 1975

UNITED STATES OF AMERICA
IN THE UNITED STATES DISTRICT COURT FOR
THE WESTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION

UNITED STATES OF AMERICA,)
Plaintiff,) No.)
vs.) G 157-71 CA 1)
FRANK J. BEARDSLEE and)
FRANCES M. BEARDSLEE,)
his wife,)
Defendants.)
-----)

CONSENT JUDGMENT

At a session of said Court
held in the United States
District Courtroom in the
Federal Building at the
City of Grand Rapids,
Michigan, in said Division
on the 3rd day of
September, 1975.

PRESENT: Honorable Noel
P. Fox
Chief Judge
United States District
Court

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Summary judgment on the merits of this case having previously been granted the plaintiff, United States of America, by District Judge Albert J. Engel on October 10, 1972, and the above-named defendants, Frank J. Beardslee and Frances M. Beardslee, through their attorneys, Schmidt, Heaney, Howlett & Van'T Hof, having consented to entry of judgment as to damages against them and in favor of the plaintiff, said damages to be in an amount based upon a Stipulation and the exhibits attached thereto, entered into by the parties, which has been filed with the Court, and the Court being advised in the premises:

IT IS ORDERED that judgment may be and hereby is entered for the United States of America and against the said defendants Frank J. Beardslee and Frances M. Beardslee, in the amount of \$186,957.84 together with interest on this amount at the rate of 6 per cent per annum from September 3, 1975, and for costs in the amount of \$41.00. The judgment in the above-stated amount consists of the following:

Note dated October 22, 1964	
Principal	\$ 7,288.62
Accrued interest as of	
Sept. 3, 1975	2,054.07
Total	\$ 9,342.69
Daily accrual Rate	
\$1.139885	

Note dated May 3, 1967 -	
Principal	120,019.81
Accrued interest as of	
Sept. 3, 1975	57,595.34
Total	177,615.15
Daily Accrual Rate	
\$19.003147	
Judgment	\$186,957.84

Defendants are free to appeal the summary judgment order entered on the merits finding them liable under the guaranties at issue.

/s/ Noel P. Fox
Chief Judge
United States District
Court

Dated: September 9, 1975

UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION - GRAND RAPIDS

UNITED STATES OF AMERICA,)
)
Plaintiff,) File
)
v.) G-157-71 CA
)
FRANK J. BEARDSLEE and)
FRANCES M. BEARDSLEE, his)
wife,)
)
Defendants)
-----)

O R D E R

In the above entitled matter, the defendants have moved for a rehearing pursuant to FRCivP 59. The parties have waived oral argument and have submitted the motion to the court on briefs.

Upon due consideration, defendants' motion for rehearing is hereby DENIED.

IT IS SO ORDERED.

ALBERT J. ENGEL
District Judge

Dated:
December 26, 1973